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March 16, 2009

AGENDA 9a

TO: MEMBERS OF THE INVESTMENT COMMITTEE

I. SUBJECT: Member Home Loan Program Annual Review

II. PROGRAM: Member Home Loan Program

III. RECOMMENDATION: Information Only

IV. ANALYSIS:

Program Legislative History

In March 1979, California State Assemblyman Dave Elder introduced Assembly Bill 1342 which provided permissive authority for CalPERS Board to establish a member home loan program (MHLP).

After numerous Board discussions and program plan revisions, Assembly Bill 1342 passed by a vote of 79 to 0 in the Assembly and 21 to 10 in the Senate and became effective January 1981. In September 1980, CalPERS Legal Office drafted regulations to implement the bill which were reviewed by the Board and subsequently approved by the Office of Administrative Law in June 1981. Government Code Section 20200 authorizes and Regulations 561-561.14 interprets and implements the MHLP.

In 1989, Assemblyman Elder introduced additional legislation (Assembly Bill 46) to establish CalPERS Secured Personal Loan Program (SPLP). SPLP provides down payment assistance financing for members seeking to buy a home and is used in conjunction with the MHLP. Under SPLP, members can pledge up to 50% of their accumulated retirement contributions as collateral for a loan amount not to exceed the lesser of 5% of the home purchase price or $18,421. After two Assembly Bill revisions, the third bill was signed into law by the Governor in September 1992.

Program Administration History

In the early 1980’s, First Interstate Mortgage and First Nationwide Savings and Loan originated and serviced MHLP loans for CalPERS members. Over time, more lenders expressed interest in participating in the MHLP. In 1988, the Investment Committee approved a conduit lending concept, whereby one or more institutions would oversee origination activities of numerous lenders certified to do MHLP loans and provide master servicing for those loans. In 1989, Lomas Mortgage USA was selected as program manager and master servicer under the conduit program.

In 1995, Lomas Mortgage USA filed for bankruptcy and sold off master servicing rights to First Nationwide Mortgage Corporation. Shortly thereafter, the Investment Committee assigned MHLP management responsibilities to First Nationwide Mortgage Corporation. In 2002, CitiMortgage acquired Golden State Bancorp, the parent company of First Nationwide Mortgage Corporation, thereby changing the banner of MHLP management and master servicing responsibilities to CitiMortgage.

In 2006, the Investment Committee elected to conduct a Request for Proposal for the MHLP. Although four firms registered to respond to the RFP (Bank of America, US Bank, Countrywide and CitiMortgage), only CitiMortgage responded and was awarded a new contract in 2008.

MHLP Operational Overview

The MHLP provides mortgage financing to qualified members seeking to refinance or purchase owner-occupied homes. The MHLP offers members a variety of conservative loan options, traditionally focused on fixed rate loans with terms of either 15 or 30 years. Through the MHLP, first-time and repeat home buyers can take advantage of 100% financing opportunities. One scenario involves borrowers obtaining 95% financing through the MHLP and 5% financing through CalPERS’ SPLP.

CalPERS members obtain mortgage financing from lenders which are certified by CitiMortgage to originate and fund MHLP loans. CitiMortgage is contractually obligated to purchase the MHLP loans from these participant lenders. CitiMortgage then pools together the majority of these loans for delivery to Fannie Mae (FNMA) in exchange for mortgage-backed securities which CalPERS purchases. The remaining loans that are not eligible for FNMA or Ginnie Mae (GNMA) securitization are sold directly to CalPERS as whole loans.

(See Attachment 1 for a flowchart of the MHLP Loan Origination, Purchase, Securitization and Investment Cycle.)

Program Advantages

CalPERS MHLP offers members several distinct advantages including interest-rate float down opportunities, controlled closing costs and discounted escrow and title fees.

Under MHLP's interest rate float down feature, members lock in an interest rate and receive the lowest interest rate offered on three key dates: the original lock date (frequently the day of loan application), the date of final loan approval, and the date the loan documents are drawn.

As program manager, CitiMortgage reviews final loan documents to make sure members closing costs do not exceed levels allowed under the MHLP. The program manager also protects members against discount point "overages", which are arbitrary fees which some lenders charge on non-MHLP loans to increase the compensation to the mortgage originator.

Program Manager Responsibilities

CitiMortgage has general administrative and supervisory responsibilities for the MHLP. As program manager, CitiMortgage supervises participating lenders, has responsibility for marketing the MHLP, facilitates the securitization and sale of mortgage-backed securities and whole loans, and provides program performance reports to CalPERS staff.

Additionally, CitiMortgage serves as master servicer for all loans originated under the program. A master servicer generally oversees the activities of primary servicers who interact directly with homeowners. A master servicer also receives and reconciles monthly remittances and reports, disburses funds to CalPERS as investor, monitors defaulted loans, periodically reviews the financial condition of participant lenders and assures that custodial documents are properly handled.

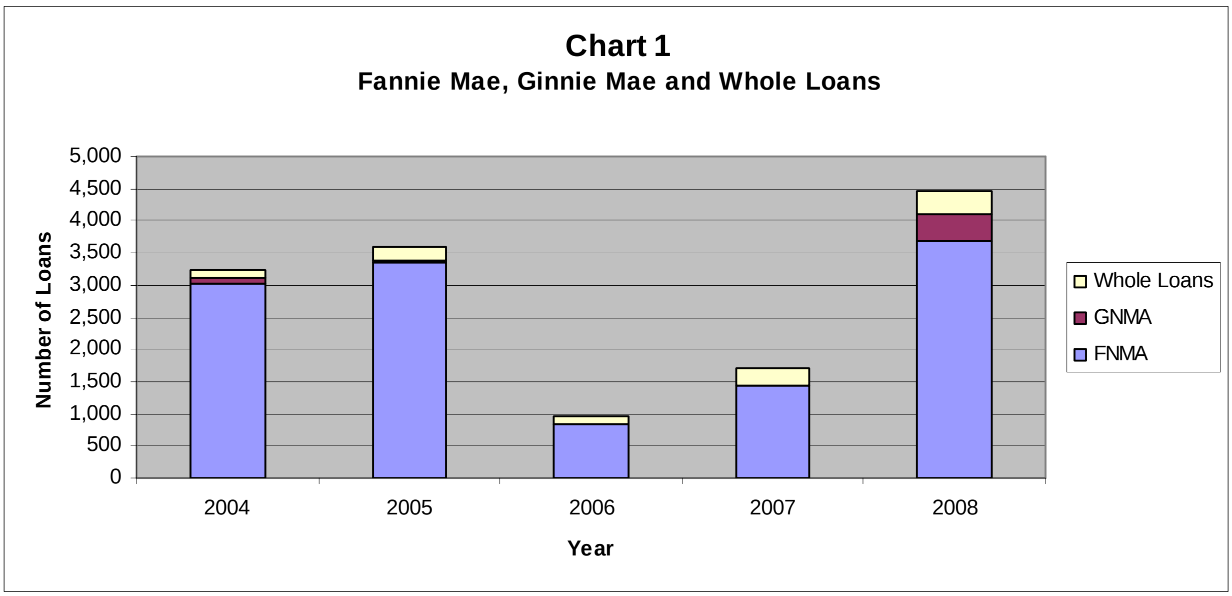
Program Performance

<u>Market Environment</u>

The mortgage origination industry is returning to more conservative underwriting guidelines in response to the housing crisis that resulted from the wide use of "affordability mortgages" like interest-only and negative amortization loans. The MHLP's traditional conservative underwriting model has become the industry standard again. The other major change in the mortgage market is the near universal lack of availablity of non-FNMA and non-GNMA loans. Non-conforming loans such as jumbo loans (loans that exceed FNMA maximum loan size) are essentially unavailable in today's market for all but the most credit-worthy borrowers.

MHLP Production Levels

Given the MHLP's conservative product offering and loan underwriting standards, the MHLP saw an increase in loan production in 2008 during which 4,465 loans were purchased for a total volume of $1.16 billion. In 2007, a total of 1,701 MHLP loans were purchased for a total volume of $415 million. Chart 1 illustrates historical MHLP loan production levels since 2004.

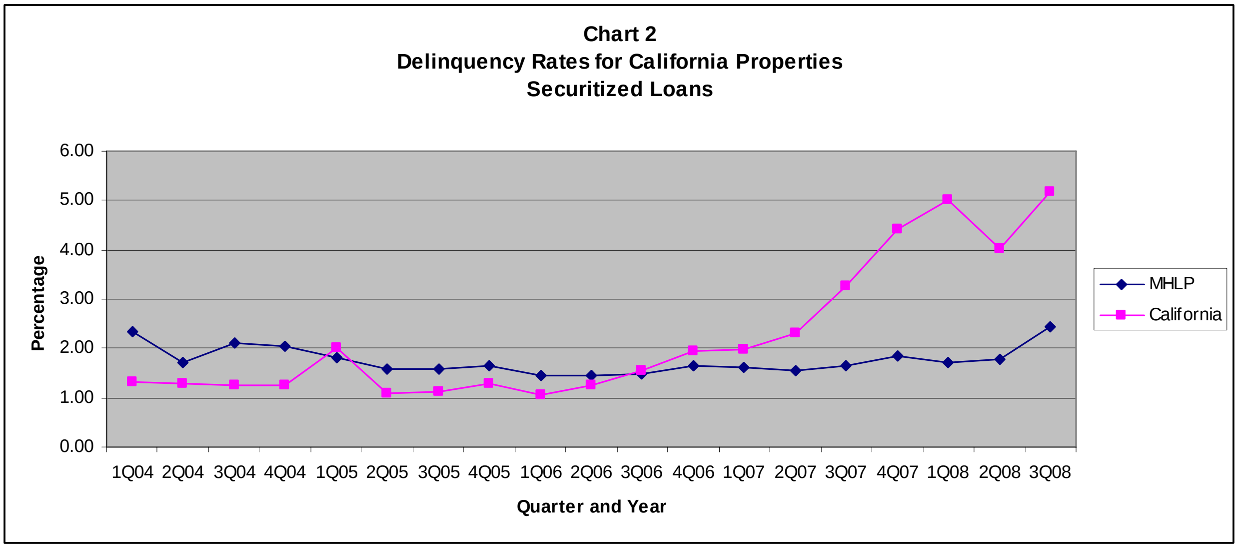


Since the inception of the program in 1981, over 133,000 loans have been provided to members with a total volume exceeding $21 billion.

Member Home Loan Delinquency and Foreclosure Performance in 2008

MHLP loans which have been securitized (with FNMA and GNMA) had significantly lower delinquency and foreclosure ratios than industry averages and represent approximately 97% of MHLP loans currently being serviced. As of September 30, 2008, the MHLP total delinquency ratio for the FNMA and GNMA securitized loans was 2.45% compared to a statewide delinquency ratio of 5.18%.

Chart 2 illustrates historical loan delinquency levels on securitized loans compared to industry averages since 2004.

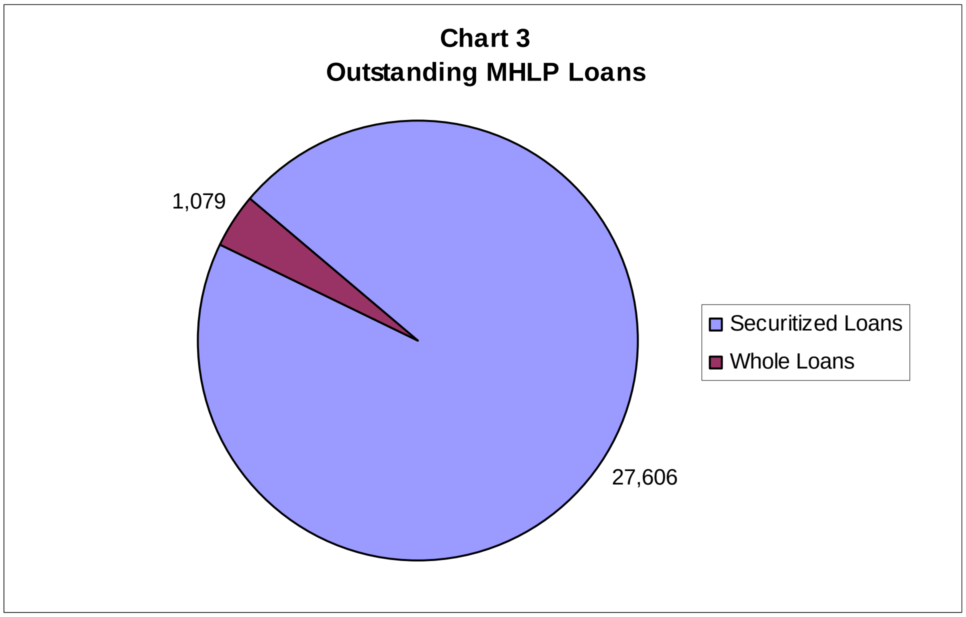


Foreclosure ratios on MHLP securitized loans was 0.10% compared to the statewide average of 2.04%.

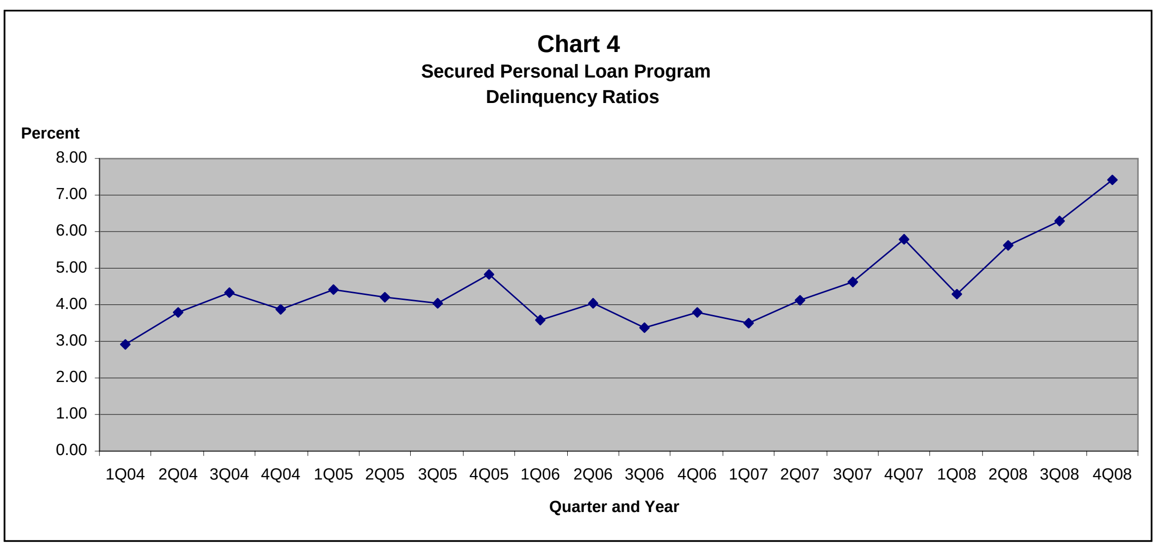
Ratios as of September 30, 2008	MHLP Securitized Loans	Non-MHLP Prime Loans California Statistics
Overall Delinquency Ratios	2.45%	5.18%
Foreclosure Ratios	0.10%	2.04%

Source: MHLP Quarterly Updates and Mortgage Bankers Association.
Delinquent loans are those at least 30 days late or are in foreclosure.

Of the total number of MHLP loans currently being serviced, approximately 3% are whole loans owned directly by CalPERS and not guaranteed by FNMA or insured by GNMA. MHLP whole loans have a delinquency ratio of 7.8% which is higher than the delinquency ratio for FNMA and GNMA loans. This is primarily because loans which become delinquent prior to being pooled by FNMA or GMNA must be purchased by CalPERS as whole loans (delinquent loans are not eligible for pooling). Since the number of outstanding whole loans is relatively small compared to the total number of loans being serviced, adding delinquent loans to the whole loan portfolio greatly impacts the ratio. Chart 3 illustrates the proportion of securitized loans to whole loans.



SPLP loan delinquencies have been gradually increasing since the advent of the subprime mortgage crisis in mid-2007. As of December 31, 2008, approximately 7.40% of all personal loans were at least 30 days delinquent compared to 5.78% as of December 31, 2007 and 4.64% as of June 30, 2007. Chart 4 illustrates delinquency trends of the SPLP.



Within the next three months staff will come back to the Investment Committee with recommended changes to enhance the value of the MHLP program.

V. STRATEGIC PLAN:

Monitoring and review of CalPERS Member Home Loan Program is consistent with Goal V: Provide sustainable pension benefit products and services responsive to and valued by members, employers and stakeholders.

VI. RESULTS/COSTS:

The continuation of the Member Home Loan Program is not anticipated to incur any increased costs to CalPERS.

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